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September 27, 2007

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

OCT 2 2007

CC:PA:LPD:PR (REG-142695-05)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Proposed Regulations On Cafeteria Plans

Dear Sir or Madam:

I would appreciate it if you would consider the following comments and questions as you finalize the proposed regulations.

1. I have a question regarding the example in section 1.125-1(h)(3). The example states that an employee elects salary reduction for accident and health coverage for a former spouse and that the fair market value of this coverage is $1,000. The example concludes that the employee has $1,000 includible in gross income for this coverage. If the employee's salary reduction is $1,000 and is made on an after-tax basis, does this example mean that the employee has both (i) $1,000 includible in gross income by virtue of the $1,000 of salary that was used to purchase the benefit on an after-tax basis and (ii) another $1,000 includible in gross income by virtue of the fair market value of such coverage? If so, that does not seem to be the correct result. If the employee is paying fair market value for the coverage with after-tax dollars, the fair market value of the coverage should not be included in the employee's gross income again, should it?

2. Please add an example to section 1.125-5(d)(4) that illustrates the rule regarding terminated participants in section 1.125-5(d)(3). Also, you may want to reconcile this rule with the example in section 1.125-6(a)(2)(iii). It is my understanding that the reason why the former employee in this example is not required to be reimbursed for the post-termination medical expense is that the employee's contributions in the amount of $600 covered the period ending June 30, 2009 and, as a result, those contributions do not relate to the period from the date when the employee ceased to be a participant through the end of that plan year. Would the

result be different if the employee had paid the full $1,200 contribution for the year by June 30, 2009?

3. Would you consider expanding the rule in section 1.125-5(k)(3) regarding advanced payments for orthodontia to include advanced payments for prenatal treatments and fertility treatments? It is my understanding that providers often require advanced payments for such treatments.

4. Could you specifically address, in section 1.125-7, a situation where an employer excludes highly compensated individuals from a premium-only cafeteria plan, because the employer pays 100% of their health insurance premiums (they cannot elect cash instead), while the nonhighly compensated individuals must reduce their compensation under the cafeteria plan to pay all or a portion of their health insurance premiums? Is this discriminatory in violation of Code section 125(b)(1)? The plan benefits all the nonhighly compensated individuals so it is does not seem to be discriminatory as to eligibility under section 1.125-7(b). There are no highly compensated participants so there would not seem to be any discrimination as to contributions or benefits "under the plan" in violation of section 1.125-7(c). Nonetheless, it does not seem that such an arrangement is within the spirit of the nondiscrimination rules. I find no portion of the proposed regulations, however, that would treat those employer contributions for the health insurance premiums for the highly compensated individuals as if they were made through the cafeteria plan (which could be at odds with example 4 of section 1.125-1(b)(4)(iii)). Does section 1.125-7(l)'s anti-abuse rule reach this situation?

5. The example in section 1.125-7(e)(4) is not very helpful. Could you provide an example that is not so straightforward?

6. Should the reference in section 1.125-7(f)(1) to the safe harbor percentage test in paragraph (b)(3) be to paragraph (b)(1)?

7. Section 1.125-7(g) permits disaggregation of a plan into component plans for nondiscrimination testing purposes based on employees with less than three years of employment and those with at least three years of employment. Would you consider other permissive disaggregation along the lines permitted for Code section 401(a) plans (see, for example, section 1.401(a)(4)-2(c) regarding rate groups)?

Thank you for your consideration.

Respectfully submitted,

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